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C O N F I D E N T I A L SECTION 01 OF 03 DAMASCUS 005788

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TAGS: ECON EINV ENRG EPET ETTC SY
SUBJECT: SUBJECT: SYRIA,S ACHILLES, HEEL : ITS OIL SECTOR

Classified By: CDA: Stephen Seche for Reasons 1.5 b/d

¶1. (C) Summary. The SARG hopes to attract new investment in its oil sector by hosting an international bidders, seminar next week. According to conventional wisdom, the Syrian economy is expected to face a potential crisis in three to five years when the country crosses over from being a net exporter to becoming a net importer of oil, unless the SARG takes dramatic action to revitalize the sector and diversify its economic base. Feeding this scenario, the heart of the Syrian oil industry) the Shell/Syrian joint venture) is witnessing a dramatic decline in production. Likewise, nearly all US companies have either divested or are in the process of divesting their interests in Syria,s oil sector. Despite the forecasts, the sector still holds some promise. Though its &easy oil8 has already been exploited, Syria retains oil and gas resources that are of interest to international companies and an infrastructure with spare capacity. New production from Syria,s last bid round in 2003 could start coming on-line as early as 2007, in time to help moderate any potential crisis, if present plans hold. End Summary.

The Economics

¶2. (U) The oil sector has been a pillar of the Syrian economy since the mid-1980,s. It currently accounts for approximately 20 percent of GDP, 65-70 percent of exports, and 50 percent of government revenue. Oil production reached its peak in 1996, producing over 600,000 bpd, and has been in steady decline since. At the same time, Syria is facing rising consumption of gas and electricity, seven and nine percent respectively, which further decreases the amount of oil available for export. If the current trend holds, Syria is expected to switch from being a net exporter to become a net importer of oil in the next three to five years. Local economists and proponents of economic reform highlight this shift as being the most compelling economic event facing the country. They argue that without comprehensive SARG action to open up and diversify the economy, the country will soon face a significant economic crisis.

¶3. (C) Industry sources are less alarmist. They comment that the SARG may be correct in hoping that rising natural gas production will offset diminished oil production to some extent. Secondly, they expect Syria's oil sector to continue to benefit from high prices, which continue to draw new investment to the sector. If managed correctly, they opine, Syria could witness significant new production coming on-line at just the right time) in three to five years. They comment that the biggest obstacle to realizing this is the SARG,s own chronic mismanagement of the sector.

Declining Production

¶4. (SBU) The backbone of Syria,s oil industry remains the al-Furat Petroleum Company (AFPC), a joint venture between the state-owned Syrian Petroleum Company (SPC) which owns 50 percent of AFPC, and Royal Dutch Shell and PetroCanada who split the second 50 percent, 62/38 respectively. AFPC produces a high quality, light crude that sells at one to two USD below Brent. AFPC uses the oldest pipeline in the Middle East, the Kirkuk-to-Banyas pipeline, to move its product to market. Though the pipeline has a rated capacity of 1.2 million bpd, Shell executives tell us that there is not a lot of spare capacity even with AFPC,s declining production levels. They attribute the limited spare capacity to the fact that the state-owned Syrian company responsible for running the pipeline has invested very little in maintenance in the last ten-plus years.

¶5. (C) AFPC,s oil production peaked in 1996, at over 300,000 bpd, but has been declining ever since. In recent years, AFPC has lost roughly 30,000 bpd of production per year. In 2004, AFPC produced 213,000 bpd. This year production is expected to average 183,000 bpd. AFPC forecasts production to decline further to 153,000 bpd in ¶2006. In an effort to control the rate of decline, AFPC is applying technology to increase its rate of recovery, currently targeted at 50 percent. AFPC also has an ambitious

drilling plan that fully utilizes the available in-country rigs. According to Hisham Yazigi, general manager for PetroCanada, AFPC,s strategy is to slow down the rate of production decline to the maximum extent possible, but further decline is inevitable.

¶6. (C) Recent international news stories on Syria,s declining oil sector have pointed to PetroCanada,s decision this year to explore the possibility of divesting of its junior interest in AFPC as proof of the lack of promise the sector holds. Yazigi disputes this, claiming instead that Shell and PetroCanada have both profited greatly from their interests in AFPC and continue to do so. For its part, PetroCanada is considering selling its share in AFPC because of a change in its management philosophy whereby it now seeks to be the operator of all of its overseas interests. Yazigi commented that PetroCanada was pleasantly surprised at the level of initial interest in its AFPC shares when news of its possible sale first leaked out. Far from leaving Syria, Yazigi says PetroCanada is looking for ways to expand its presence (see below).

¶7. (U) SPC is the other major oil producer in Syria. The company has produced oil in Syria,s northeast for decades. Its current production level is estimated to be around 180,000 bpd. It is expected that SPC's production may soon overtake AFPC, but the oil it produces is a heavy-grade, high sulfur oil that sells at 20 to 30 USD below Brent, depending on the time of year. A 30-inch, 200,000 bpd pipeline carries the SPC oil from the northeast to the refinery at Homs. What isn,t used in the refinery is added to the Kirkuk-Banyas pipeline for export from the port at Banyas. SPC does have one field that produces a high-grade oil, similar to AFPC,s, but its production is only around 5000 bpd.

¶8. (U) Total,s joint venture with SPC is the only other current oil producer of significance in Syria. Similar to AFPC, Total,s production has recently been in decline, from 66,000 bpd some years ago to an estimated 33,000 bpd today. Total also uses the Kirkuk-to-Banyas pipeline to move its oil. Total is, likewise, using technology and an ambitious drilling plan to slow its production,s rate of decline. At least one sector contact told us that he expects Total,s production to actually start to increase modestly as a result of the company's efforts.

New Exploration

¶9. (C) The SARG last offered blocks for international bidding in 2003. A number of production sharing contracts (PSC) were subsequently signed with firms ranging from Croatia to the US. The US companies all subsequently left, but activity in their blocks continues. The most promising oil developments are Gulfsands' in the extreme northeast of the country, and PetroCanada,s, which borders it. Gulfsands, a London based company, started shooting its seismic this month, with plans to start drilling in early April 2006. Gulfsands managers told us they estimate the oil holding formations in their block are capable of having up to 10 times more oil than the formations common in SPC,s areas. Unless the political situation deteriorates further, Gulfsands managers believe their company could be producing between 50 to 100,000 bpd of high grade oil within three years.

¶10. (C) PetroCanada has finished shooting seismic in the new block it was awarded in 2003 and had planned to drill one or two wells before the end of the year. A lack of in-country drilling rigs has compelled PetroCanada managers to change their plans. Since Total and AFPC have all available rigs in-country fully booked, PetroCanada now plans to begin drilling its first well in July 2006. In spite of the delay, PetroCanada managers still believe they could bring new production on line as early as 2007. Because of the existing infrastructure and the spare capacity in the Kirkuk-Banyas pipeline, PetroCanada engineers estimate the company must only construct a 65-kilometer spur for PetroCanada to be able to move its oil to market.

New Bidding Round

¶11. (C) On November 7 and 8, Syria will hold a bidders' conference on seven new blocks for oil and gas exploration. Bids will be due on December 21, with the SARG expected to award the new blocks early in 2006. In addition to soliciting bids, the conference is designed to highlight opportunities countrywide in both the oil and gas sectors. Dubai based, IBC Gulf Conferences is organizing the event on behalf of the Syrian Ministry of Petroleum and Mineral Resources. Local industry representatives who have attended other IBC conferences have been critical of the quality of the company,s services. Shell,s general manager Campbell Keir was equally critical of the SARG,s own ability to promote its oil sector. Keir commented that in the last bidding round in 2003, the SARG,s efforts at promotion were so hopeless that Shell finally had to step in. Keir said

Shell ended up even having to pay for an ad in the Economist as the SARG couldn,t manage to make the payment on its own. According to Keir, the SARG has done equally little to promote this round, leaving everything to IBC, which he and others judge to not be up to the task.

¶12. (C) Still, with oil over 60USD per barrel, there is considerable interest in Syria,s oil sector in spite of the SARG,s poor marketing. The general manager for Conoco Phillips, William Duey, describes the interest in Syria as &frothing8 and a side effect of how over-heated the sector is worldwide. According to Duey, in the present market Syria is attractive to medium and small companies that are unable to get their foot in the door in other markets. Duey commented further that because of its lax environmental and regulatory policies, Syria is viewed as a good place for companies that aspire to becoming operators, like Gulfsands, to start. Duey said the same is true for the Chinese, who have been frustrated in their efforts to break into other markets in the Middle East. For them, Syria offers the opportunity to establish a presence in the region.

¶13. (C) Shell's Keir is more dismissive of the type of companies Syria is attracting. According to him, the companies interested in Syria are not to be taken seriously. He believes their goal to be nothing more than getting a hold of a block with some promise, shooting &a little seismic,8 maybe drilling one or two wells, hyping its worth, and then selling out for as much as possible, as quickly as possible. Keir opined that no other major, besides Shell, would participate in the present bidding round so very little real development of the sector could be expected. Keir added that even Shell was undecided whether it would actually submit a bid or not given the unstable political situation, though he felt there were blocks that were of significant potential.

¶14. (C) Comment. The oil sector will undoubtedly remain important to Syria,s economy for the foreseeable future. With oil at 60USD per barrel, the conditions are favorable for the SARG to reverse the sector's current downward slide. Still, those most likely to turn the sector around - Shell, PetroCanada, and Gulfsands) are all watching with great concern developments affecting Syria's political stability. The SARG, however, seems to be counting on companies from eastern Europe, Russia, India, and China to be able to replace any lost investment from the West, but these companies have yet to produce any oil of significance in Syria. In any case, the SARG has increasingly less time to ensure its continuing membership in the select club of oil-exporting countries.
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